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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS, INC., and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN, THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN, THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN, and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

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Respondents.

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

PRELIMINARY STATEMENT

The Securities Industry Association, Inc. ("SIA"), A.G. Edwards & Sons, Inc. ("A.G. Edwards"), Advest, Inc. ("Advest"), Alex. Brown & Sons Incorporated ("Alex. Brown"), Bateman Eichler, Hill Richards Incorporated ("Bateman Eichler"), Birr Wilson Securities, Inc. ("Birr Wilson"), Boettcher & Company, Inc. ("Boettcher"), The Chicago Corporation ("The Chicago Corporation"), D.A. Davidson & Co. ("Davidson"), Dean Witter Reynolds, Inc. ("Dean Witter"), Dominick & Dominick, Incorporated ("Dominick"), Goldman, Sachs & Co. ("Goldman"), Howard, Weil, Labouisse, Friedrichs Inc. ("Howard Weil"), J.C. Bradford & Co. ("J.C. Bradford"), J.J.B. Hilliard, W.L. Lyons, Inc. ("Hilliard Lyons"), Johnston, Lemon & Co., Incorporated ("Johnston Lemon"), Mer-

rill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Moseley Securities Corporation ("Moseley"), Nomura Securities International, Inc. ("Nomura"), Piper, Jaffray & Hopwood Incorporated ("Piper Jaffray"), Prescott, Ball & Turben, Inc. ("Prescott Ball"), R.G. Dickinson & Co. ("R.G. Dickinson"), Rauscher Pierce Refsnes, Inc. ("Rauscher Pierce"), Raymond James & Associates, Inc. ("Raymond James"), and Wheat First Securities, Inc. ("Wheat First"), submit this brief as *amici curiae* in support of the Petitioners, and urge this Court to reverse the opinion and judgment of the Second Circuit below in *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986). Pursuant to Rule 36.1 of the Rules of this Court, the written consent of Petitioners Shearson/American Express, Inc., and Mary Ann McNulty and Respondents Eugene and Julia McMahon, The David J. Hodder & Son, Inc. Employee Pension Plan, The David J. Hodder & Son, Inc. Profit Sharing Plan, The Laurie Funeral Home, Inc. Employee Pension Plan, and The Laurie Funeral Home Profit Sharing Plan has been obtained and has been filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

SIA is the principal trade association of the securities industry, having as members more than five hundred securities firms in the United States and Canada. As such, it has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers may be enforced. Because arbitration is an efficient, fair, speedy, and economical manner of resolving disputes, most of SIA's members have agreed with many of their customers to arbitrate any controversies arising between them. Among these members are *amici curiae* A.G. Edwards, Advest, Bateman Eichler, Birr Wilson, Boettcher, The Chicago Corporation, Davidson, Dean Witter, Dominick, Goldman, Hilliard Lyons, Howard Weil, J.C. Bradford, Johnston Lemon, Merrill Lynch, Moseley, Nomura, Piper Jaffray, Prescott Ball, R.G. Dickinson, Rauscher Pierce, Raymond James, and Wheat First.

Certain *amici* are parties to cases pending in this Court and the lower federal courts that involve one or both of the issues presented herein.[1] The procedural outcome of those actions will be affected by the Court's decision herein. *Amici curiae* therefore have a substantial interest in this Court's decision upon whether agreements to arbitrate claims arising under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1962-64 ("RICO"), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act"), are enforceable as valid contracts under Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (the "Arbitration Act"). *Amici* seek to clarify and make uniform the law on these issues so that the enforceability of arbitration provisions in agreements with their customers can be predicted and relied upon. SIA has also filed briefs *amicus curiae* on these issues to this Court in support of the petition for *certiorari* in this action and in *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213 (1985), to the Second Circuit below, and to the Third, Sixth, Eighth, Ninth, and Eleventh Circuits.

SUMMARY OF ARGUMENT

The opinion of the United States Court of Appeals for the Second Circuit below, *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), which held that predispute arbitration agreements are unenforceable with respect to both RICO and Section 10(b) claims, reflects the suspicion courts once held of the arbitral process, *see Wilko* v. *Swan*, 346 U.S. 427 (1953), rather than recognizing the con-

1 Petitions for *certiorari* have been filed with the Court by *amici* Merrill Lynch and Dean Witter in *Dean Witter Reynolds, Inc.* v. *Conover*, 55 U.S.L.W. 3159 (U.S. Aug. 29, 1986) (No. 86-321), *Merrill Lynch, Pierce, Fenner & Smith Incorporated* v. *Jacobson*, 55 U.S.L.W. 3259 (U.S. Sept. 25, 1986) (No. 86-487), *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 55 U.S.L.W. 3296 (U.S. Oct. 7, 1986) (No. 86-578), and *Merrill Lynch, Pierce, Fenner & Smith Incorporated* v. *Badart*, 55 U.S.L.W. 3317 (U.S. Oct. 10, 1986) (No. 86-591). Petitions have also been filed in at least two other cases raising these issues, *Kidder, Peabody & Co. Incorporated* v. *Intre Sport Ltd.*, 55 U.S.L.W. 3023 (U.S. Jul. 16, 1986) (No. 86-40), and *Drexel Burnham Lambert Inc.* v. *King*, 55 U.S.L.W. 3153 (U.S. Aug. 25, 1986) (No. 86-282).

gressionally enacted federal policy endorsing arbitration as an efficient means of resolving disputes. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, ____ U.S. ____, 105 S. Ct. 3346 (1985); *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984); *Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. 1 (1983). That policy is especially appropriate with regard to the securities industry. The various securities exchanges and the National Association of Securities Dealers, Inc., have established permanent arbitration facilities, adopted rules that ensure procedural fairness, and assembled arbitration panels whose competence cannot be questioned. They have done so under the supervision of the Securities and Exchange Commission. Statistical evidence shows that, in cases that are not settled before a hearing, a customer stands an excellent chance of recovering an award from a securities industry arbitration panel.

In addition to its misconception of the policies involved, the Second Circuit failed to apply the correct legal standard: whether Congress manifested an intention to repeal the Arbitration Act with respect to RICO and Section 10(b) claims in the text or legislative history of those statutes. No such intention can be demonstrated with respect to either statute, and the Arbitration Act therefore applies to RICO and Section 10(b) claims.

Last, *Wilko* v. *Swan* does not require a different result with respect to Section 10(b) claims. There, a mistrust of the arbitration process led the Court to hold that predispute agreements to arbitrate were unenforceable as to the unusual, express "special right" of action under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"). The Court's subsequent rejection of those qualms, as well as the reasoning behind the *Wilko* decision, in *Mitsubishi*, raises grave doubts as to *Wilko*'s applicability with respect to claims not brought under Section 12(2). Moreover, the implied right of action under Section 10(b) contains none of the unique features that made Section 12(2) a "special right" and prompted the decision in *Wilko*.

POINT I

ARBITRATION IS FAVORED AS AN EFFICIENT AND WIDELY ACCEPTED MEANS OF RESOLVING BROKER-CUSTOMER DISPUTES IN THE SECURITIES INDUSTRY

The United States Arbitration Act provides that an agreement to arbitrate in a contract involving interstate commerce is valid to the same extent as any other contract. When Congress passed the Arbitration Act in 1925, it established a clear federal policy favoring the use of arbitration to resolve disputes. That policy marked a decisive shift from the hostility to arbitration then prevalent in the courts. Although it did not meet with immediate favor in the courts, *see, e.g., Wilko* v. *Swan*, 346 U.S. 427, this Court has often found occasion to recognize it in recent decisions. In *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, the Court observed:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

105 S. Ct. at 3354. *Accord Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24 (the Arbitration Act "is a congressional declaration of a liberal federal policy favoring arbitration . . . [and] questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"); *Southland Corp.* v. *Keating*, 465 U.S. at 10 (in passing the Arbitration Act, "Congress declared a national policy favoring arbitration . . . [that] mandated the enforcement of arbitration agreements"); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). *See also Wilko* v. *Swan*, 346 U.S. at 439 (Frankfurter, J., dissenting) ("[t]here is nothing in the record . . . to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled").[2]

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2 The language in *Mitsubishi*, *Moses H. Cone*, and *Southland* echoes Justice Frankfurter's dissenting language in *Wilko*, 346 U.S. at 439,

The opinion of the Second Circuit below ignored the congressionally mandated policy favoring arbitration. That opinion rested on the assumption that arbitration of RICO and Section 10(b) claims will somehow undermine substantive rights under those statutes. In apparent disregard of what this Court has stressed time and again on the subject, the Second Circuit stated, "[I]n other contexts, we have recognized the *inappropriateness* of the United States Arbitration Act when strong public policy considerations are involved." 788 F.2d at 98 (emphasis added). Leaving aside its dubious validity as a matter of law, this assumption is untenable as a matter of fact, especially with regard to the securities industry.

The established structure of arbitration in the securities industry refutes the Second Circuit's assumption that the enforcement of contracts to arbitrate securities disputes will dilute the protection of investors under the securities laws. Securities exchanges and the National Association of Securities Dealers, Inc. (the "N.A.S.D."), under the supervision of the Securities and Exchange Commission, provide arbitration facilities for disputes between member firms and their public customers.[3] The current procedures have evolved since 1872,

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rather than the majority's concern in *Wilko* that arbitration of Section 12(2) claims would endanger the "special rights" created thereby, 346 U.S. at 435. This Court's recent statements thus suggest that the policy underpinnings of *Wilko* no longer retain the same force as when *Wilko* was decided. At the very least, *Wilko* should not be extended beyond the Securities Act to Exchange Act or RICO claims, especially given the dearth of any legislative evidence showing that Congress intended to repeal the Arbitration Act with respect to those claims. *See* discussion, *infra*, at 15-16.

3 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3701; 2 N.Y.S.E. Guide (CCH) ¶ 2600 (Rule 600); Uniform Code of Arbitration § 1, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (April 1986) (Exhibit C). The Uniform Code was annexed to the Brief of *Amici Curiae* in Support of the Petition for a Writ of *Certiorari* herein (the "*Certiorari* Brief") as Appendix A. Copies of the arbitration rules of the American Stock Exchange, Inc., the New York Stock Exchange, Inc., and the N.A.S.D. were filed with the Court as Parts I, II, and III of the Supplemental Lodging of *Amici Curiae* in Support of the Petition for a Writ of *Certiorari* herein.

when the New York Stock Exchange, Inc., first adopted arbitration procedures. The N.A.S.D. has maintained arbitration facilities for more than forty years. The exchanges and the N.A.S.D. also have permanent arbitration staffs. Their rules and constitutions contain detailed codes of arbitration procedures.[4] Moreover, the Securities and Exchange Commission has approved the implementation and operation of this arbitral system, *see* Exchange Act Release No. 16390, S.E.C. (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979), and retains jurisdiction to monitor the fairness of arbitration proceedings. *See* Section 19 of the Exchange Act, 15 U.S.C. § 78s.

The long established competence of securities industry arbitrators to adjudicate disputes should dispel any suspicion of the arbitral process in that industry. The stock exchanges and the N.A.S.D. keep permanent lists of arbitrators. These lists comprise senior securities industry personnel, attorneys, and other professionals from outside the industry, who are well versed in the field. *See, e.g.*, Panel of Arbitrators 1986-1987, 1 Am. Stock Ex. Guide (CCH) 157-59; N.A.S.D. Manual (CCH) ¶ 3702. Most have previously served as arbitrators and are therefore well acquainted with arbitration procedures and customs. Thus, this Court's observation in *Mitsubishi* that "adaptability and access to expertise are hallmarks of arbitration," 105 S.Ct. at 3357, hits the mark with respect to the securities industry. Indeed, far from considering themselves as the only tribunal capable of hearing securities disputes, the federal courts have recognized securities industry arbitrators as qualified to resolve those claims. Courts have long compelled arbitration of Section 10(b) disputes between members of a securities exchange or the N.A.S.D. *See, e.g., Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.*, 287 F. Supp. 766, 772 (S.D.N.Y. 1968). Claims

4 *See, e.g.*, Constitution of the New York Stock Exchange, Inc., Art. VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357; Rules 600-634 of the New York Stock Exchange, Inc., *id.* ¶¶ 2600-2634; Uniform Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743; Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J.

under Section 10(b) are routinely arbitrated if the public customer chooses to arbitrate. *See*, *Gardner* v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971); *Moran* v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968); *cf. AVC Nederland B.V.* v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) (affirming the dismissal of a Section 10(b) claim because the parties had agreed to try all disputes in the Netherlands).

The arbitration rules of the N.A.S.D. and the various stock exchanges further ensure that arbitration practice in the securities industry will be efficient and impartial. For example, these rules require that panels of arbitrators include members of the securities industry and of the public.[5] They require a majority of "public" arbitrators (i.e., unaffiliated with member firms) in disputes between public customers and member firms unless the customer requests otherwise.[6] Arbitrators are required to disclose any business affiliation with any parties before them, and may be disqualified for cause for even the appearance of a conflict of interest.[7] Each party in an arbitration has at least one peremptory challenge.[8]

The arbitration itself proceeds much like a trial. The parties have the right to be present at the hearing, to be represented by counsel, to cross-examine witnesses, and to take a transcript of the hearing. They may subpoena witnesses and documents just as in a court proceeding, and may also compel the presence of any employee of a member of the sponsoring institution at a

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5 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9541 (Rule 601); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

6 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

7 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542(f) (Rule 602)(f); N.A.S.D. Manual (CCH) ¶ 3723; 2 N.Y.S.E. Guide (CCH) ¶ 2610 (Rule 610); Uniform Code of Arbitration § 11.

8 *See, e.g.*, Uniform Code of Arbitration § 10.

hearing, regardless of whether that employee would be within the subpoena power of the courts of the state where the hearing is held.[9] Moreover, arbitrators serve, and witnesses testify, under oath.[10] The fairness of these rules and procedures is borne out by the results of arbitrations conducted under them. In 1985, 55% of public customer cases that went to arbitration before one of the stock exchanges or the N.A.S.D. and were decided—rather than being settled—awarded damages to the customer.[11]

Any lingering doubt as to the efficiency and fairness of arbitration as a means of resolving Section 10(b) or RICO disputes is quelled by the history of *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 795 F.2d 1393 (8th Cir. 1986), *petition for cert. filed*, 55 U.S.L.W. 3296 (U.S. Oct. 7, 1986) (No. 86-578). There, following this Court's decision in *Dean Witter Reynolds Inc.* v. *Byrd*, the plaintiff's state and common law claims were referred to an N.A.S.D. arbitration panel consisting of a former judge of the Illinois Court of Appeals, a professor of law at DePaul University, two attorneys, and the compliance director of a broker-dealer firm. The panel acepted legal briefs from the parties, heard testimony, entertained objections, and allowed both parties to call expert witnesses. The parties made opening and closing statements. At the conclusion of the hearing, counsel for the claimant thanked the panel for affording his client "an opportunity to be heard, a good opportunity, and equal too." *See Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, No. 86-578, Joint Brief for Respondents at 8-9. In July, 1985, the

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9 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶¶ 9546, 9548-49, 9551A (Rules 606, 608-09, 612); 2 N.Y.S.E. Guide (CCH) ¶¶ 2614-15, 2619-20, 2624 (Rules 614-15, 619-20, 624); Uniform Code of Arbitration §§ 15-16, 20-21, 25.

10 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551B (Rule 613); 2 N.Y.S.E. Guide (CCH) ¶ 2625 (Rule 625); Uniform Code of Arbitration § 26.

11 Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A). This report was annexed to the *Certiorari* Brief as Appendix B.

arbitrators granted an award of $1,200,000 in favor of the plaintiff. The award was confirmed by the district court on September 19, 1985, and has been paid. *See Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 795 F.2d at 1395. Plainly, the arbitrators in *Phillips* were well able to resolve the factual dispute presented to them.

Moreover, the arbitration process significantly reduces discovery expenses and minimizes delay in reaching a hearing. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3358; C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 286 (1984). For example, state laws generally provide subpoena power to arbitrators and counsel, and parties are encouraged to produce documents "to the fullest extent possible without resort to the issuance of the subpoena process."[12] Arbitrators may also direct the appearance of persons associated with member organizations or the production of records of these organizations without using the subpoena process.[13] That most stock exchanges and the N.A.S.D. offer a streamlined arbitration procedure for smaller claims also enables customers to resolve small disputes without incurring great expense.[14] Arbitration also offers an expeditious result. According to statistics compiled by the Securities Industry Conference on Arbitration, nearly 2800 securities industry arbitrations were filed with stock exchanges and the N.A.S.D. in 1985, and 2190 arbitrations in the securities industry were resolved during that year.[15] The 1985 figures

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12 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9548 (Rule 608); N.A.S.D. Manual (CCH) ¶ 3732; 2 N.Y.S.E. Guide (CCH) ¶ 2619 (Rule 619); Uniform Code of Arbitration § 20; C. Katsoris, *supra*, at 286.

13 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9549 (Rule 609); N.A.S.D. Manual (CCH) ¶ 3733; 2 N.Y.S.E. Guide (CCH) ¶ 2620 (Rule 620); Uniform Code of Arbitration § 21.

14 *See, e.g.*, 2 Am. Stock Ex. Guide ¶ 9551H (Rule 619); N.A.S.D. Manual (CCH) ¶ 3710; 2 N.Y.S.E. Guide ¶ 2601 (Rule 601); Uniform Code of Arbitration § 2.

15 *See* Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986).

represent more than twice the number of arbitrations filed in 1982, an indication of the acceptance arbitration of securities disputes has gained.[16]

Finally, the excessive caseload in the federal district courts makes it all the more important that arbitrable claims between securities firms and their customers proceed to arbitration. Filings of securities and commodities claims have steadily increased to 3266 in 1985.[17] Filings of RICO civil actions have risen as well, from 42 in November, 1985, to 99 in April, 1986.[18] Since the average caseload per federal District Judge in 1985 was 474,[19] referring Section 10(b) and RICO claims to arbitration would effectively create up to six new federal district judgeships, which would help to relieve the federal courts of their overloaded dockets.

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16 The number of filings rose from 1340 in 1982 to 2796 in 1985. *See id.*

17 Annual Report of the Director of the Administrative Office of the United States Courts, Table 19 (1985). Table 19 was annexed to the *Certiorari* Brief as Appendix C. These figures are calculated on the basis of a year beginning July 1. "1985" statistics therefore refer to the period July 1, 1984, through June 30, 1985.

18 Communication from the Administrative Office of the United States Courts, Statistical Analysis and Reports Division.

19 Administrative Office of the United States Courts, Federal Court Management Statistics 1985 at 167.

POINT II

CONGRESS DID NOT REPEAL THE UNITED STATES ARBITRATION ACT WITH RESPECT TO CLAIMS BROUGHT UNDER THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT

Because there is neither a textual conflict between RICO and the Arbitration Act nor any evidence in RICO's legislative history that Congress intended to repeal the Arbitration Act with respect to RICO claims, the Second Circuit erred in holding that RICO claims are not arbitrable.[20] It is well settled that any finding of an implied repeal of the Arbitration Act must be supported by "congressional intention expressed in some other statute," *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3355, which is the traditional standard for finding that a federal statute has been repealed by implication by a subsequently enacted federal statute. *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. at 88 (" 'repeals by implication [of a prior statute by a subsequently enacted one] are disfavored' ") (quoting *Allen* v. *McCurry*, 449 U.S. 90, 99 (1980)); *Morton* v. *Mancari*, 417 U.S. at 550 ("In the absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable").

In *Mitsubishi*, this Court stated:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protec-

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20 Of the other Courts of Appeals that have reached a decision on the issue, the Fifth Circuit has held that RICO claims are arbitrable, *Mayaja, Inc.*, v. *Bodkin*, No. 85-2762 slip op. (5th Cir. Oct. 24, 1986), and the Third and Eleventh Circuits have held that a RICO claim is not arbitrable if predicated on a violation of a federal statute that gives rise to a non-arbitrable right of action, *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 797 F.2d 1197 (3d Cir. 1986); *Tashea* v. *Bache Halsey, Stuart, Shields, Inc.*, Nos 85-5768, 85-5967, slip op. (11th Cir. Oct. 21, 1986).

> tion against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

105 S. Ct. at 3355. Under this test, there can be no question that predispute agreements to arbitrate RICO claims are enforceable under the Arbitration Act. RICO contains no statutory language that restricts a party's ability to agree to an arbitral forum with respect to RICO claims, nor is there any evidence in RICO's legislative history that Congress intended to repeal the Arbitration Act with respect to RICO claims. Absent such evidence, the Arbitration Act must apply to RICO claims, and agreements to arbitrate those claims must be honored as ordinary contracts.

The Second Circuit did not pretend to apply the *Mitsubishi* test. It cited no statutory text or legislative history to support a repeal of the Arbitration Act. Instead, it based its holding on "the *inappropriateness* of the United States Arbitration Act when strong public policy considerations"—never identified further—are involved. 788 F.2d at 98 (emphasis added).[21] It made no attempt to balance these "strong public policy considerations" with the express congressional policies embodied in the Arbitration Act, policies that this Court has often affirmed. *E.g.*, *Mitsubishi Motors Corp.* v. *Soler Chrysler-Ply-*

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21 The Second Circuit's attempt to apply to RICO its antitrust decision in *American Safety Equipment Corp.* v. *J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (holding that antitrust law claims are not subject to predispute arbitration agreements), ignores the "skepticism" this Court expressed about *American Safety* in *Mitsubishi*. 105 S. Ct. at 3357. The Court's criticism of *American Safety* in *Mitsubishi* precludes the application of the *American Safety* decision to RICO claims. The only *American Safety* consideration that this Court recognized as valid in *Mitsubishi* was "the fundamental importance to American democratic capitalism of the regime of the antitrust laws." 105 S. Ct. at 3358. That consideration has no parallel in RICO, especially in its civil aspect, which, as this Court has noted, "is evolving into something quite different from the original conception of its enactors." *Sedima, S.P.R.L.* v. *Imrex Co.*, ___ U.S. ___, 105 S. Ct. 3275, 3287 (1985); *see also Mayaja, Inc.* v. *Bodkin*, *supra*, slip op. at 8 (LEXIS format) ("Mitsubishi rejected so much of *American Safety*'s reasoning that it is difficult to say what is left of the opinion to rely on").

mouth, 105 S. Ct. at 3354; *Southland Corp.* v. *Keating*, 465 U.S. at 10; *Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24-25; *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 510-11. In sum, the Second Circuit's substitution of its own policy judgment for the policy Congress mandated in the Arbitration Act cannot stand as a matter of law, and the opinion below should be reversed.

Equally unfounded are the holdings of the Third and Eleventh Circuits in *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 797 F.2d 1197 (3d Cir. 1986), and *Tashea* v. *Bache, Halsey, Stuart, Shields, Inc.*, Nos. 85-5768, 85-5769 slip op. (11th Cir. Oct. 21, 1986): that a RICO claim is not arbitrable if it is predicated on a nonarbitrable claim. What Congress may have intended with respect to a claim based on facts that may also constitute a "predicate offense" under the RICO statute has no bearing on what Congress intended when it created a separate right of action under RICO. That the Third and Eleventh Circuits had to resort to such a tortuous legislative argument vividly reflects their inability to find any basis for an implied repeal of the Arbitration Act in the text or history of the RICO statute.

The holdings in *Jacobson* and *Tashea* also rest on a fundamental misunderstanding of RICO. They assume that a RICO claim is no more than a claim for damages caused by the commission of one of the "predicate offenses" identified in RICO. Yet a "predicate offense" is but one component of a RICO claim. A RICO plaintiff must also prove that the defendants conducted a criminal enterprise and engaged in a pattern of racketeering activity. *Sedima, S.P.R.L.* v. *Imrex Co.*, 105 S. Ct. at 3285. Even if the securities laws were construed to void agreements to arbitrate claims for Section 10(b) fraud, this conclusion does not bear upon whether the distinct elements of a RICO claim based on a Section 10(b) "predicate offense" may be tried before an arbitration panel. *Mayaja, Inc.* v. *Bodkin*, *supra*, slip op. at 8-9 (LEXIS format); *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, *supra*, 797 F.2d at 1209 (Adams, J., dissenting).

POINT III

THE RULE OF *WILKO* v. *SWAN* SHOULD NOT BE EXTENDED TO THE IMPLIED RIGHT OF ACTION UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

As with its RICO holding, the Second Circuit extended the rule of *Wilko* v. *Swan* to cover Section 10(b) claims without the requisite showing under *Mitsubishi* that Congress intended to repeal the Arbitration Act with respect to such claims. Since there can be no such showing, the decision below should be reversed.[22]

Neither the reasoning nor the facts of *Wilko* v. *Swan* justify its extension to Exchange Act claims. *Wilko* held that a party asserting a claim under Section 12(2) of the Securities Act could not be compelled to submit his claim to arbitration pursuant to a predispute arbitration agreement. The Court expressed concern that arbitrators would be unfamiliar with the "special right" expressly created by Section 12(2), a right that differed significantly from a traditional action for common law fraud. It found that arbitrators, as a matter of federal law, are not subject to "judicial instruction on the law", 346 U.S. at 436, and need give no explanation of their award, and that their "conception of the legal meaning of such statutory requirements as 'burden of proof', 'reasonable care' or 'mate-

22 Since this Court again declared the issue to be an open question in *Dean Witter Reynolds Inc.* v. *Byrd*, the Second Circuit below and the Third, Fifth, Ninth, and Eleventh Circuits have held that predispute agreements to arbitrate are not enforceable with respect to Section 10(b) claims. *Jacobson* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, *supra*, 797 F.2d 1197; *Bustamente* v. *Rotan Mosle, Inc.*, No. 86-2300 slip op. (5th Cir. Oct. 17, 1986); *Conover* v. *Dean Witter Reynolds Inc.*, 794 F.2d 520 (9th Cir. 1986); *Wolfe* v. *E.F. Hutton & Co., Inc.*, 800 F.2d 1032 (11th Cir. 1986). The Eighth Circuit in *Phillips* v. *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, 795 F.2d 1393, held that the Arbitration Act does apply to agreements to arbitrate Section 10(b) claims and renders them as enforceable as any other contract.

rial fact' . . . cannot be examined . . . ." *Id.* The Court accordingly voided predispute agreements to arbitrate as a waiver of substantive rights in violation of Section 14 of the Securities Act, 15 U.S.C. § 77n (voiding any agreement to waive compliance with that Act).

Wilko's reasoning does not easily reconcile with the Court's holdings in *Mitsubishi*, *Byrd*, *Moses H. Cone*, and *Southland*. The confidence those cases showed in the arbitral system—a confidence that is especially justified with respect to the securities industry—parallels Justice Frankfurter's dissenting language in *Wilko* far more closely than it does the majority's doubts in that case as to the availability of a full and fair hearing of securities claims in arbitration. Even more fundamentally, *Wilko*'s assumption that an agreement to arbitrate waives substantive rights stands on precarious footing today. This Court has clearly stated in *Mitsubishi* that, "By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." 105 S. Ct. at 3355. Unless that statement is to be ignored, unless *Mitsubishi* is to be construed as holding that a waiver of compliance with the antitrust laws is permissible, the reasoning of *Wilko* appears so at odds with *Mitsubishi* as to cast serious doubts on *Wilko*'s validity beyond its peculiar facts.

Moreover, *Wilko* is inapposite by its own terms to an agreement to arbitrate Section 10(b) claims. Although Section 29(a) of the Exchange Act contains a non-waiver provision similar to Section 14 of the Securities Act, 15 U.S.C. § 78cc(a), this Court has acknowledged that its applicability to an implied cause of action under Section 10(b), as opposed to an express private right of action like Section 12(2), is far from clear. *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 215 n.1 (opinion of the Court); *id.* at 224-25 (White, J., concurring); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 515. As Justice White pointed out in his concurring opinion in *Byrd*, the reasoning of *Wilko*

"cannot be mechanically transplanted to" Section 10(b) claims, and *Wilko*'s applicability to Section 10(b) claims "is a matter of substantial doubt." 470 U.S. at 224. The comparison between Sections 12(2) and 10(b) invited by the concurring opinion in *Byrd* proves to a certainty that *Wilko* cannot apply to Section 10(b) claims.

Section 10(b) contains none of the unique provisions upon which the reasoning of *Wilko* is founded. Section 12(2) "*created* a special right" (emphasis supplied) in that it provided a congressionally designed, express private right of action to an aggrieved purchaser of securities. *See Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 209-10 (1976); *Wilko* v. *Swan*, 346 U.S. at 431. In contrast, Section 10(b) does not provide an express private right of action. It contains none of the "carefully drawn procedural restrictions", *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 210, present in the express remedies set forth in the Securities Act and the Exchange Act, but closely resembles a traditional common law fraud action. *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. at 225 (White, J., concurring). Thus, *Wilko*'s concern that arbitrators might not understand the unusual features of Section 12(2)—even if legitimate—finds no parallel in Section 10(b). *Cf. Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. 3354.

That a Section 10(b) claim is only an implied private right of action gainsays that Congress thereby created a "special right" or intended to exempt it from the Arbitration Act, as required by *Mitsubishi*. The private right of action under Section 10(b) is the creation of the lower federal courts in which this Court has acquiesced. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983).[23] Unlike the express right of action under Section

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23 Because of the history of recognition by the lower federal courts of a private cause of action under Section 10(b), "the existence of this implied remedy is simply beyond peradventure." *Herman & MacLean* v. *Huddleston*, 459 U.S. at 380. Other than noting the failure of

12(2), it cannot be considered part of the statutory scheme of the Exchange Act.[24] Accordingly, neither Section 10(b) nor the legislative history of the Exchange Act permit the conclusion that Congress, in adopting that legislation, thereby intended to repeal the Arbitration Act. It is one thing for the lower federal courts to infer a private right of action for damages where Congress has created none; it is quite another for those courts by so doing to repeal the strong public policy favoring arbitration given effect by Congress in the Arbitration Act.

That Congress, in amending Section 28 of the Exchange Act, 15 U.S.C. § 78bb, in 1975, took note of the decision in *Wilko*, H. R. Rep. No. 229, 94th Cong., 1st Sess., 111, reprinted in 1975 U.S. Code Cong. & Ad. News 321, 342, relied on by the Ninth and Eleventh Circuits in *Conover* v. *Dean Witter Reynolds Incorporated*, 794 F.2d 520 (9th Cir. 1986), and *Wolfe* v. *E.F. Hutton & Co., Inc.*, 800 F.2d 1032 (11th Cir. 1986), has no bearing on the inquiry. How Congress interpreted the Exchange Act more than forty years after its passage does not qualify as evidence of its original intent in passing that Act. That the Ninth and Eleventh Circuits could turn up no legislative evidence contemporaneous with the passage of Section

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Congress to deny a private right of action under Section 10(b) during its numerous amendments of the Exchange Act, a point which often holds little significance in matters of statutory interpretation, *see Girouard* v. *United States*, 328 U.S. 61 (1946), the Court did not examine the legislative intent of Congress in enacting Section 10(b), the critical test for determining whether a right of action is implicit in a federal statute. *See Cort* v. *Ash*, 422 U.S. 66 (1975); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979).

24 The early decisions that inferred a private right of action from Section 10(b) did so not on the basis of factors enumerated in this Court's decision in *Cort* v. *Ash*, 422 U.S. 66 (1975), but on the basis of a "tort" analysis founded on Section 286 of the Restatement of Torts. American Law Institute, Restatement of Torts § 236 (1934). *See Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), and *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951). This analysis was rejected by the Court in *Cort* as a basis for judicial inference of implied causes of action. *See also Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677 (1979).

10(b) to support an implied repeal of the Arbitration Act confirms that none exists. Moreover, at the time the congressional report cited in *Conover* and *Wolfe* was issued, this Court had clearly held the arbitrability of Section 10(b) claims to be an open question in *Scherk*. *Conover* and *Wolfe* would thus read the congressional report as misstating the law as it then stood with respect to Section 10(b) claims, and their attempt to bootstrap such a misunderstanding into an original intent to repeal the Arbitration Act will not pass muster under *Mitsubishi*.

The Second Circuit based its holding below upon a generalized policy argument of its own making, that "[t]he securities laws generally, and the implied causes of action which the Courts have recognized, are designed to protect the public." 788 F.2d at 98. Yet, since "we are well past judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals," *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth*, 105 S. Ct. at 3354, this policy argument in no way conflicts with the arbitration of implied Section 10(b) claims. The Second Circuit therefore erred in refusing to enforce the parties' agreement to arbitrate Section 10(b) claims, and its decision should be reversed.

CONCLUSION

For the reasons set forth above, the opinion of the United States Court of Appeals for the Second Circuit should be reversed.

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